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Real estate industry developments - 1998/99; Audit risk alerts

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AUDIT RISK ALERTS

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Real Estate Industry Developments—1998/99

Notice To Readers

This Audit Risk Alert is intended to provide auditors with an overview of recent industry, economic, technical, and professional developments that may affect the audits they perform. It has not been approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA.

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1 2 3 4 5 6 7 8 9 0 AAG 9 9 8

In This Year's Alert...

Table of Contents

Real Estate Industry Developments—1998/99

Industry and Economic Developments

General Industry Trends and Conditions

What is the overall condition of the real estate industry? What are the current trends?

Through much of 1998, the prevailing mood within the real estate industry was one of restrained enthusiasm. The general sense of optimism reflected the continued strength of most real estate markets, as evidenced, for example, by increasing rents, lower vacancies, and a steady flow of capital into all industry segments. At the same time, many industry analysts urged caution and restraint, fearful that an irrational exuberance may lead to overbuilding and a downturn in the industry similar to that experienced at the beginning of this decade. Thus, in assessing current industry conditions, real estate companies and their auditors must strike an appropriate balance between optimism over the current state of affairs and a conservative outlook toward the future.

The current state of the economy is positive. In spite of the recent volatility in the financial markets and the continuing political and economic crises in Asia and Russia, the fundamentals of the U.S. economy remain strong. The current economic expansion is now in its eighth year, one of the longest periods of sustained growth in history. Typically, inflation slows and then stops such periods of growth, but at this time, inflation remains well under control.

The real estate industry has enjoyed a recovery similar to that of the economy as a whole. Only a few short years ago, the industry was plagued by illiquidity and a lack of capital. Now, after the demand for space has finally caught up with supply, that is no longer the case. Most industry analysts remain optimistic that the underlying conditions that have fueled the industry's recovery will continue into the near future. (Subsequent sections of this

Audit Risk Alert discuss the economic conditions of specific industry segments.)

However, this enthusiasm for the current state of affairs is tempered by an almost palpable sense of restraint. Historically, the real estate industry has been subject to cycles of boom and bust. Periods of increasing demand and rising prices are quickly followed by overbuilding and speculative construction, which ultimately leads to oversupply. Currently, after several years of recovery, the industry is on the verge of a significant new construction cycle, as the demand for real estate in several sectors is beginning to outpace supply. If developers, capital providers, and others in the industry can manage to discipline the coming development cycle, there is every reason to believe the industry will remain stable and avoid the dramatic downturns that have characterized its past.

There have been several important trends in recent years in the real estate industry. One of the most far-reaching trends has been the continued consolidation within the industry. Driven by the philosophy that bigger is better, 1998 was marked by an unusually high number of corporate consolidations in all segments of the economy, and the real estate industry was no exception.

Traditionally, real estate entities tended to be privately held, entrepreneurial enterprises. This type of structure provides two advantages: (1) the direct linkage between property performance and management compensation (superior motivation), and (2) quicker decision making (superior flexibility).

Through consolidation, real estate companies are abandoning traditional organizational strategies and attempting to realize the benefits achieved by size. These targeted benefits include—

- Ready access to equity markets and other, cheaper sources of capital.
- Lower transaction costs by providing a broad range of integrated real estate services.

- Improved quality of management.
- Lower overhead by combining staffs.

In addition to mergers and acquisitions, real estate entities also are positioning themselves to realize some of the same benefits of size by forming large joint ventures and strategic alliances, which also is changing the nature of the industry.

All this consolidation does not necessarily mean the death of the smaller, privately held, real estate company. Many of these companies have managed not only to survive but also to thrive by developing a niche market, such as military base privatization or assisted-living facilities. In the past few years there has been a marked increase in the number of real estate entities that are highly specialized, either by product type or geography.

Another significant development in the real estate industry has been the trend toward public ownership of real estate, most notably through real estate investment trusts (REITs). REITs now control approximately 6 percent of the real estate market, but if you eliminate properties that are not likely to attract large investors (owner-user space and smaller properties in third- and fourth-tier cities) their share of the market is even higher. According to the National Association of Real Estate Investment Trusts (NAREIT, the national trade association for real estate companies) the REIT industry has grown more than tenfold since 1991, and NAREIT anticipates continued rapid expansion.

In 1998 there were several noteworthy shifts in the availability of capital for real estate investment. Throughout most of the year, the industry experienced what many considered to be an abundance of equity capital, driven by a return of institutional investors making direct investments and significant activity in the public markets. With such large amounts of capital at their disposal, most investors tended to consider larger properties as a way to realize efficiencies. A primary concern was whether investors, armed with an abundance of capital, could find deals that made economic sense—where the pricing reflected the fundamental supply and demand conditions of the market.

During the last quarter of the year, a new concern worried industry analysts. Volatility and instability in global financial markets severely curtailed the demand for asset-backed bonds, such as commercial mortgage-backed securities (CMBSs). As a result, finance companies that provide and securitize loans to real estate companies experienced severe liquidity problems. For real estate companies, this meant a credit crunch that some analysts predicted was only the tip of the iceberg. It remains to be seen how widespread this lack of financing will become and ultimately how it will affect the real estate industry.

Industry Segment Conditions

What is the overall condition of individual segments of the real estate industry? What are the significant trends in these industry segments?

Office Market Conditions

The office market continues to be strong, characterized by a significant amount of investment activity, particularly from pension funds and REITs. Signs of the continued strength of office properties and current market trends include the following:

- *Lower vacancies.* The demand for office space has been fueled by increases in jobs, particularly in the financial services, high technology, and communications sectors. According to the real estate advisory firm Cushman & Wakefield, the national vacancy rate for downtown office buildings has dropped five percentage points since the second quarter of 1996. Lower vacancies have resulted in higher rental rates and the disappearance of large rental concessions.
- *Lower initial cap rates.* The supply of capital to this sector of the real estate market has put a downward pressure on cap rates. Additionally, many investors of office properties are acting as arbitrageurs, focusing on acquiring properties with soon-to-expire rents at below market rents. The strategy is to realize significant appreciation in the value of the property by quickly rolling over these old leases to higher, market rents. This trend also has contributed to lowering cap rates.

- *Shift away from suburban office markets.* Investors in office properties have been turning away from smaller, suburban properties and toward larger properties in the downtown, central business districts.
- *Increase in new construction.* During the first half of 1998, approximately 350,000 square feet of new downtown office space was completed. In contrast, the industry expected 2,900,000 square feet to be completed during the second half of 1998. Estimates of new office construction for the next two years are 2,200,000 square feet in 1999 and another 2,000,000 square feet in the year 2000.

Industrial Market Conditions

The growth of exports and the resulting revitalization of the U.S. manufacturing industries have played a large role in the economic expansion of the 1990s. This growth in manufacturing has resulted in a healthy industrial real estate market, particularly for warehouse and distribution facilities. However, several significant trends are reshaping this segment of the industry, including:

- *Changing fundamentals for warehouse and distribution facilities.* Vacancies for warehouse and distribution facilities are beginning to edge upwards. Additionally, there has been a surge of recent construction of these types of properties, which may outpace demand.
- *Rising demand for light assembly and research and development (R&D) facilities.* In the past few years developers and investors have been focusing on warehouse and distribution facilities, largely ignoring the more labor-intensive light assembly and R&D properties. As a result, the supply of these properties has not kept pace with demand. And demand is expected to increase, particularly for R&D, as U.S. corporations will spend heavily in this area to keep up with the quickening pace of technological change.

Retail Market Conditions

For the past few years the retail market has been plagued by high vacancy rates and an oversupply of space. Competition in the retail industry is fierce and will continue into the future. This heavy competition will continue to place upward pressure on cap rates for retail real estate properties.

However, there are signs of improvement in the retail industry. Most notably, the economic recovery of the 1990s has added billions of dollars in consumer purchasing power to the economy, and median household income, adjusted for inflation, is the highest it's been in nearly a decade. As a result, retail property productivity, measured in terms of sales per square foot, has begun to show modest improvement.

One significant operating trend for the retail segment has been the development of specializations and niche marketing strategies. To distinguish themselves from their competitors, many malls have had to focus on a particular niche, such as entertainment or travel-related tie-ins. Traditional suburban shopping centers that have not yet adopted such an approach will be challenged to reinvent themselves and maintain their customer base. Many malls are adding services such as medical offices or dentists to replace their retail tenants.

Residential Market Conditions

Both the multifamily and single-family markets are strong and should remain relatively stable into the near future. According to a recent report by the Census Bureau, the percentage of U.S. households that own their own home is at an all-time high. The Census Bureau also projects annual increases of approximately 1.1 percent (1.15 million units) in the number of U.S. households for each of the next ten to fifteen years. This projected increase together with the current low mortgage interest rates make most analysts bullish on the single-family housing market.

The projected increase in the number of households also bodes well for the multifamily housing market. Research performed by Landauer Research Group indicates that the market should be able to absorb 325,000 new units per year. Apartment rents continue to rise at 3 percent to 5 percent per year, which—although a positive sign–is slower than recent increases due to the effects of recent new apartment construction. Although the multifamily market remains strong, slower growth is expected in most regions of the country.

Finally, the most significant demographic trend affecting the residential market is the overall aging of the American population. This has created a fast-growing niche in the senior housing market. This market is not homogeneous and covers a wide range of living arrangements, including active retirement communities, congregate care facilities, and continuing care programs. Many developers of senior housing are partnering with health care providers.

Real Estate Investment Trusts (REITs)

What are some of the important trends in the REIT industry? How have recent tax law changes affected REITs?

As mentioned earlier, REITs continue to grow in size and importance to the real estate industry. Other important trends for REITs include—

- *Consolidation and specialization.* Like the industry as a whole, REITs continue to grow through merger and acquisition. Also, like many other segments of the industry, REITs are increasingly developing a niche strategy, focusing exclusively on narrow segments of the industry such as entertainment properties or prisons.

- *Stock prices reflecting underlying asset value.* Recently, REIT stocks have traded at a premium above the net asset value of the underlying real estate. That situation is unlikely to continue, so look for stock prices to come more into line with net asset value.

The Taxpayer Relief Act of 1997 (TRA '97) became law on August 5, 1997. Several provisions in that law affected REITs—both the requirements for qualification as a REIT and the taxation of a REIT. Under TRA '97—

- A REIT may now earn up to 1 percent of its gross income, on a property-by-property basis, from nominal services to customers and still treat amounts received with respect to that property as rent.

- REIT shareholders will receive a tax credit when a REIT sells a property, retains the sales proceeds, and pays a corporate level tax.
- The 30 percent gross income test for qualification as a REIT has been repealed.
- A REIT that fails to send timely shareholder letters will be levied a penalty of $25,000 rather than be disqualified. Additionally, a REIT that sends out shareholder letters and does not know of a "five or fewer" violation is now deemed to satisfy this ownership test.
- For purposes of the 95 percent gross income test, REIT hedging rules are expanded so that income from all types of liability derivatives are now considered qualifying income.

On July 22, 1998, the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 became law. Although the law focuses on overhauling the operations of the IRS, it also contains provisions affecting paired-share REITs, essentially limiting the tax benefits of those entities.

Executive Summary—Industry and Economic Developments

- Through much of the year, the real estate industry was in full recovery and at the beginning of a period of significant new construction. Analysts had urged restraint to avoid the kind of market downturn experienced at the beginning of this decade. However, a shortage of the availability of commercial credit developed near year end, threatening continued industry growth.
- Significant consolidation within the industry and the trend toward public ownership, most notably through REITs, are two significant trends that are reshaping the nature of the industry.
- The office market is strong, marked by lower vacancies and cap rates. Significant increases in new construction are planned for the next two years.
- The industrial market remains healthy, although vacancies for warehouse and distribution facilities are beginning to edge upwards.
- The retail market has been plagued by high vacancy rates and an oversupply of space, although there are signs that this is beginning to

change. Specialization and niche marketing strategies are changing this segment of the industry.

- Multifamily and single-family residential markets remain strong. Projected increases in the number of U.S. households should keep this market strong into the future.
- REITs continue to grow in size and importance to the real estate industry.

Current Audit Issues

Assessing Audit Risks in the Current Environment

How do current economic trends and conditions affect the risks associated with auditing real estate entities?

Auditors should be aware of their responsibilities as set forth under Statement on Auditing Standards (SAS) No. 22, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 311). SAS No. 22 requires, in part, that in planning the audit, the auditor should consider matters affecting the industry in which the entity operates, including current economic conditions. With respect to audits of real estate entities, this would include the factors described in the previous section. In particular, the economic conditions just described may be relevant to the auditor when—

- Evaluating audit risk and the business risks faced by the entity.
- Considering the reasonableness of significant accounting estimates and their underlying assumptions.

Evaluating Audit Risks

An auditor's evaluation of audit risk should start with a good understanding of the client's business. To develop a good undestanding of a real estate entity, an auditor should be knowledgeable about the entity's strategies for dealing with business conditions, both current conditions and those most likely to exist in the near future. In the real estate industry, business conditions vary greatly across property types and from region to region. The risks associated with developing office buildings are different from those faced by a homebuilder; a warehouse facility in the Northeast may face different issues than a similar facility located on the Pacific Coast. For this reason, an auditor must be knowledgeable about property types (for example, office, retail, or industrial) and the location in which the entity operates.

Audit risk can be altered when a real estate entity enters into new product types or new geographic markets. Auditors should be aware that current economic conditions may force their real estate clients to expand beyond their traditional sphere of operations. Industry trends that may affect an entity in this way include—

- *Specialization.* The increasing specialization of real estate entities and the necessity of niche marketing strategies may require entities to expand the geographic scope of their operations. For example, an operator of assisted living facilities in the Southwest may have to expand to other locations in order to keep growing.
- *Availability of capital.* The abundance of capital in the real estate industry has resulted in a highly competitive search among investors for economic deals. In the search for these deals, entities seeking to acquire real estate may consider property types or locations that are new to them.

During audit planning, auditors should identify new product types or locations and should carefully assess the risks associated with the client's change in operating strategy.

Additionally, the real estate industry has always been characterized by a large number of unique, highly complex transactions. There is no reason to believe that the current environment will change this industry characteristic. For example, as the industry has recovered and significant construction activity begun, land has become difficult to acquire in some of the country's hottest markets. To secure rights to the land they need, developers and builders have been forced to create sophisticated and complex arrangements, alliances, and transactions. The sale or leasing of property and its financing are two other areas where creative, complex transactions tend to proliferate. Auditors should identify complex transactions during audit planning and take steps to ensure that they are accounted for in accordance with generally accepted accounting principles (GAAP).

Finally, auditors should monitor the credit crunch that developed toward the end of 1998 to see how it affects their clients. Because of a lack of financing, some transactions, including debt refinancings, may not close. Auditors should consider whether a lack of available funding raises questions about an entity's ability to continue as a going concern.

Auditing Accounting Estimates

The financial statements of real estate entities often include accounting estimates. For example, supplemental current values of real estate assets and the recognition and measurement of impairment losses both require management to make estimates of future events or assumptions about current conditions.

Authoritative guidance on auditing accounting estimates is provided in SAS No. 57, *Auditing Estimates* (AICPA, *Professional Standards*, vol. 1, AU sec. 342). Additionally, the AICPA publication *Auditing Estimates and Other Soft Accounting Information* offers nonauthoritative tips and techniques on the subject.

Currently, the real estate industry is healthy and in the early stages of significant construction activity in many segments. As the new construction is completed, the supply of space may outpace demand, creating downward pressure on rental rates and increasing vacancies. Certain estimates (for example, expected future cash flows used in the determination of possible asset impairment) require management to make assumptions about future events and conditions. Auditors should consider carefully whether these assumptions are not overly optimistic; they should consider the anticipated future conditions of the marketplace and not the conditions as they exist today.

Audit Implications of Business Combinations in the Real Estate Industry

What are some of the auditing and accounting issues that arise from the large number of consolidations taking place in the industry?

Consolidation in the real estate industry has created a shift away from privately owned, somewhat loosely controlled entities and toward larger, corporate, and more professionally managed organizations. This trend can affect audit planning in a number of ways, including—

- *Changes in vulnerability to fraud.* SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards* , vol. 1, AU sec. 316) describes two types of fraud: fraudulent financial reporting and misappropriation of assets. Smaller, owner-managed entities tend to be more vulnerable to employee theft and defalcation and other misappropriations of assets. Larger corporations with effective internal controls, although vulnerable to misappropriation of assets, also tend to be much more susceptible to fraudulent financial reporting. Auditors accustomed to auditing small, owner-managed entities should be careful not to overlook fraud risk factors relating to fraudulent financial reporting when those entities become part of larger, more structured organizations.

- *Assessing control risk below the maximum.* For most small business entities, the most efficient audit approach usually involves assessing control risk at the maximum and performing a primarily substantive audit. Out of necessity, larger organizations usually have more formal internal controls in place. To the extent that these controls are effective in reducing control risk, an auditor should consider an audit strategy of assessing control risk below the maximum in order to limit the nature, timing, and extent of substantive procedures.

- *Communications between predecessor and successor auditors.* Business combinations often result in the gain of a client for one auditor and a loss of a client for another. Thus, in the current economic environment, auditors may be more likely to find themselves in the role of either a predecessor or successor auditor. SAS No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315), provides guidance on communications between predecessor and successor auditors when a change of auditors is in process or has taken place.

In addition to the issues associated with planning the audit of an entity that has been involved in a business combination, auditors should assess whether management's accounting for the business combination is in conformity with GAAP. Relevant pronouncements include—

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 94, *Consolidation of All Majority-Owned Subsidiaries* (FASB, *Current Text*, vol. 1, sec. C51).
- AICPA Accounting Principles Board (APB) Opinion No. 16, *Business Combinations* (FASB, *Current Text*, vol. 1, sec. B50).
- AICPA Statement of Position (SOP) 78-9, *Accounting for Investments in Real Estate Ventures.*
- AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (FASB, *Current Text*, vol. 1, sec. C51).

Impact of the Asian Crisis on the U.S. Real Estate Industry

How does the financial crisis in Asia affect the real estate industry?

The financial problems in Asia have their root in the deep and prolonged recessions in countries such as Indonesia, Thailand, South Korea, Singapore, Malaysia, and Japan. These economies have been plagued by rising unemployment, upward pressure on interest rates, and falling asset prices. The resulting declines in currency values and financial markets have led to the weakening or failure of many of their major financial institutions. And the risk of further adverse developments in Asia remains substantial, with the prospect of economic recovery at least two or three years away. Given the pervasive interconnections of virtually all economies and financial systems in the world today, the associated uncertainties for the U.S. economy remain substantial as well.

Not all of the implications of the Asian financial crisis are negative. As the dollar strengthens against the Asian currencies, imports from those countries become cheaper. This in turn will help keep inflation in check, which in turn may create downward pressure on interest rates.

There is no way of knowing for sure how and to what degree the Asian financial crisis will affect the U.S. real estate industry, and many analysts see the situation as creating both threats and opportunities for industry entities.

Threats

As indicated previously, the growth in the export of goods and services has been a significant underlying cause for the expansion of the U.S. economy. This growth in exports also has been a driving force in rising property values for office and industrial properties connected to the manufacture and distribution of goods for export. The financial problems in Asia undoubtedly will reduce the amount of goods exported to that region.

Many analysts contend that a reduction in exports to Asia will have only a nominal effect on most real estate markets. In making those predictions they cite other strong economic fundamentals, such as continued domestic demand for American products, as being powerful enough to mitigate any negative consequences of reduced exports to Asia. Nevertheless, auditors should consider the extent to which an entity's underlying real estate assets are tied to Asian exports.

Opportunities

The depressed property values across much of Asia provide an opportunity for U.S. real estate entities seeking to make either a direct investment in Asian real estate or in pools of loans secured by Asian property. The abundance of capital may encourage U.S. investors to look to Asia for economic real estate deals. Auditors should assess the risks of overseas investment. Investment in foreign property may involve economic, political, and cultural considerations and risks the entity has never before encountered.

The Year 2000 Issue

What is the Year 2000 Issue? How will it affect real estate entities? How does the Year 2000 Issue affect auditors?

The Year 2000 Issue relates to the inability of many electronic data processing systems to accurately process year-date data beyond the year 1999. This is because the majority of computer programs in use today have been designed to store dates in the dd/mm/yy (date/month/year) format, thus allowing only two digits for each date component. For example, the date December 31, 1998, is stored in most computers as "12/31/98." Inherent in programming for dates in this manner is the assumption that the designation "98" refers to the year 1998. Initially developed as a cost-saving technique, this long-standing practice of using two-digit year input fields will cause many computers to treat the entry "00" as 1900. Therefore, such programs will recognize the date January 1, 2000 (01/01/00) as January 1, 1900, and process that data incorrectly, or perhaps not at all.

There are other possible complications as well. The year 2000 is a leap year. Systems that are not year 2000 ready may not register the additional day, thus producing incorrect results for date-related calculations. In addition, certain year 2000 problems may occur this year. Some software programs have assigned special meanings to date entries coded "xx/xx/98" or "xx/xx/99," and therefore may not process these transactions correctly. Similarly, failures may take place this year when systems perform calculations into or beyond the year 2000.

The Year 2000 Issue affects real estate entities in one of two general ways. First, as is the case for any other company, the Year 2000 Issue will affect the computer systems that handle accounting information and other transaction processing. Companies that run off-the-shelf, Windows-based systems should have a relatively easy time fixing any problems because most vendors have or will have versions of their software that are year 2000 compliant. However, problems could arise with—

- *DOS-based software.* Many companies have experienced year 2000 problems with DOS-based software. Unfortunately, most real estate companies currently run DOS-based property management systems because Windows-based systems are rare.
- *Legacy systems.* Some real estate companies run custom software written in older programming languages. These "legacy" systems must be updated to become year 2000 compliant.

The second Year 2000 Issue faced by real estate companies is less obvious but potentially more difficult to solve. Many building systems have embedded computer microprocessors that allow them to function. Such embedded computers can be found in virtually any automated system that controls building functions. The most important systems to check for year 2000 compliance include—

- Centralized facilities management systems.
- Energy management systems.
- Elevator and escalator controls.
- Environmental management systems.
- Fire control systems.
- Building security systems.

The difficulty with embedded computer processors is that the problems related to the year 2000 are hard to find, numerous, and oftentimes connected to other systems and to each other.

First, it must be understood that it is the responsibility of an entity's management to assess and remediate the effects of the Year 2000 Issue on an entity's systems—not the auditor's. The Year 2000 Issue does not create additional responsibilities for the auditor. Under generally accepted auditing standards (GAAS), the auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Thus, the auditor's responsibility relates to the detection of material misstatement of the financial statements being audited, whether caused by the Year 2000 Issue or by some other cause.

The AICPA's *Audit Risk Alert—1998/99* provides a more detailed discussion of how the Year 2000 Issue affects auditors, including—

- Addressing the issue in engagement letters.
- Highlighting the issue in management letters.
- Identifying the accounting issues and related authoritative pronouncements.
- Assessing possible asset impairment.
- Assessing the adequacy of disclosure for public and non-public entities.
- Identifying potential legal threats.

Auditing guidance relating to the Year 2000 Issue has been developed by the Audit Issues Task Force (AITF) of the Auditing Standards Board (ASB). The AITF has issued the following auditing Interpretations, all of which are discussed in more detail in the *Audit Risk Alert—1998/99.*

- Interpretation No. 4, "Audit Considerations for the Year 2000 Issue," of AU section 311, *Planning and Supervision* (AICPA, *Professional Standards* , vol. 1, AU sec. 9311.38-.47), discusses the auditor's responsibility with regard to the Year 2000 Issue, how it affects planning for an audit of financial statements conducted in accordance with GAAS, and under what circumstances the Year 2000 Issue may result in a reportable condition.
- Interpretation No. 3, "Responsibilities of Service Organizations and Service Auditors With Respect to Information About the Year 2000 Issue in a Service Organization's Description of Controls," of SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA,

Professional Standards, vol. 1, AU sec. 9324.19-.31), clarifies the responsibilities of service organizations and service auditors with respect to information about the Year 2000 Issue in a service organization's description of controls.

- Interpretation No. 2, "Effect of the Year 2000 Issue on the Auditor's Consideration of an Entity's Ability to Continue as a Going Concern," of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 9341.03-.27), provides guidance regarding the identification and evaluation of conditions and events of the type identified in SAS No. 59 that relate to the Year 2000 Issue.

In addition, the AITF issued attestation Interpretation No. 1, "Consideration of the Year 2000 Issue When Examining or Reviewing Management's Discussion and Analysis," of Statement on Standards for Attestation Engagements (SSAE) No. 8, *Management's Discussion and Analysis* (AICPA, *Professional Standards*, vol. 1, AT sec. 9700.01-.17), which provides guidance on the practitioner's responsibility with respect to year 2000 disclosures in Management's Discussion and Analysis (MD&A).

A more comprehensive discussion of the numerous auditing and accounting issues related to the Year 2000 Issue is presented in the AICPA publication *The Year 2000 Issue: Current Accounting and Auditing Guidance.* The publication has been updated for recent developments and provides a wealth of information for auditors including:

- Introduction to, and implications of, the Year 2000 Issue.
- Industry-specific considerations.
- Financial reporting issues.
- Auditing issues.
- Disclosure considerations.

- Auditor communications.
- Practice management issues.

This document can be obtained, free of charge, at the AICPA's Web site at www.aicpa.org.

Additionally, the Building Owners and Managers Association (BOMA) International has published a comprehensive guide titled *Meeting the Year 2000 Challenge: A Guide for Property Professionals*. The guide contains model letters and contracts, checklists, inventory forms covering twenty-five different building systems, and model language for business and legal documents. Portions of the guide can be downloaded at the BOMA Web site (www.boma.org).

Executive Summary—Current Audit Issues

- Current economic conditions and other competitive factors may force real estate companies to expand beyond their traditional locations, product types, or both. These types of operational changes can alter the risks faced by real estate entities and their auditors.
- Accounting estimates based on assumptions about future events and operating conditions should take into account projected new construction and other competitive factors expected to exist.
- Business combinations have created a shift away from privately owned, somewhat loosely controlled entities and toward larger, corporate-structured, more professionally managed organizations. This shift may require auditors to reevaluate their audit strategies, particularly in their approach to internal controls and the assessment of fraud risk.
- The Asian economic crisis provides both threats and opportunities for real estate entities. Auditors should assess how the crisis affects audit risk.
- The Year 2000 Issue will affect the computer systems of real estate entities. More importantly, it will affect the "embedded" microprocessors that operate commercial building systems such as elevators and security and environmental management systems.

Auditing and Accounting Issues of Continuing Importance

What auditing and accounting issues in the real estate industry continue to be of concern to auditors? How have current economic conditions affected these issues?

Revenue Recognition

After years of hesitancy, the fact that the real estate industry recovery is now under way may lead to overly optimistic forecasted improvements in financial results that may not materialize fully. Auditors should consider the appropriateness of their clients' revenue recognition policies or, especially, changes to those policies. Some clients may view the industry recovery as an opportunity to present improved financial results through changes in operating or accounting policies that affect the timing or propriety of revenue recognition. In evaluating the revenue recognition policies of real estate entities, auditors should consider carefully whether the criteria in FASB Statement No. 66, *Accounting for Sales of Real Estate* (FASB, *Current Text*, vol. 1, sec. R10), have been met.

Auditors also should continue to be alert for—

- *"Put" arrangements.* Put arrangements may commit a seller, its officers, or its shareholders to repurchase the property, find other buyers, or indemnify the buyer or third-party guarantors for risk of loss. These arrangements can significantly affect revenue recognition. In some cases, put arrangements may not be formally documented, so auditors should consider the facts and circumstances surrounding property sales to be sure there are no formal or informal arrangements of this kind.

- *Direct or indirect seller financing.* Auditors should consider circumstances that would indicate that a seller may have directly or indirectly provided the funds for a down payment (or for the entire purchase price) in a cash sale. Apart from precluding the use of the full accrual method of profit recognition, such circumstances may create related party transactions that require disclosure as described in FASB Statement No. 57, *Related Party Disclosures* (FASB, *Current Text,* vol. 1, sec. R36). Auditors should refer to SAS No. 45, *Omnibus Statement on Auditing Standards—* 1983 (AICPA, *Professional Standards* , vol. 1, AU sec. 334, "*Related Parties*") for guidance on procedures that should be considered to identify related party relationships and transactions.

- *Creative funding arrangements.* Some real estate transactions are structured to achieve a desired tax result. Auditors should analyze such creative funding arrangements to ensure that the transaction has been accounted for in accordance with GAAP.

FASB Statement No. 66 describes examples of real estate transactions, including sales of corporate stock of enterprises with substantial real estate, sales of partnership interests, and sales of time-sharing interests. Questions have been raised as to whether the sale of these investments should be accounted for under Statement No. 66 in accordance with FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FASB, *Current Text,* vol. 1, sec. F38). In the FASB's Emerging Issues Task Force (EITF) Issue No. 98-8, *Accounting for Transfers of Investments That Are in Substance Real Estate,* a consensus was reached that the sale or transfer of an investment in the form of a financial asset that is in substance real estate should be accounted for in accordance with Statement No. 66.

Asset Impairment

In spite of the continued recovery of most real estate markets, auditors must remain vigilant for the possible impairment of real estate assets. The subjectivity required in determining the recognition and measurement of any impairment loss reinforces the need for careful planning and execution of audit procedures in this area.

FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FASB, *Current Text*, vol. 1, sec. I08), provides the primary guidance on accounting for the impairment of real estate assets.[1] In general, the accounting for the impairment of real estate depends on whether the property is to be held for investment or held for disposal. Projects under development are accounted for in the same manner as those held for investment.

Note that Statement No. 121 does not provide exceptions for assets subject to nonrecourse debt. The FASB believes the recognition of an impairment loss should be made without regard to the nature of the debt.

Real Estate Properties Held for Investment

Real estate held for investment and projects under development should be reported at cost, less accumulated depreciation, and should be evaluated for impairment if facts and circumstances indicate that impairment may have occurred. Conditions or events such as the following may indicate a need for assessing the recoverability of investments in real estate:

- Cash flows from operating activities are insufficient to cover debt service.
- Current occupancy rates indicate that future cash flows to be received are lower than the amounts needed to fully recover the carrying amount of the investment.
- Major tenants have experienced or are experiencing financial difficulties.
- A significant portion of leases will expire in the near term.
- Lessors are being forced to make significant concessions in order to rent property.
- Properties held for sale remain unsold at subsequent balance sheet dates.

1. The Financial Accounting Standards Board (FASB) currently is preparing an exposure draft that would amend Statement No. 121. As part of this project, certain issues specifically related to real estate assets are being addressed. Progress on the deliberations of this matter is posted regularly on the FASB Web site.

- Other investors have decided to cease providing support or to reduce their financial commitment to a project or venture.
- Rental demand for a rental project currently under construction is not meeting projections.
- Auditors' reports on financial statements of investee properties are modified for reasons that relate to real estate investments. (For example, an auditor's report on the financial statements of investee properties is modified for a departure from GAAP due to improper valuation of assets.)

If events or changes in circumstances indicate that impairment may exist, the entity is required to estimate the future cash flows expected to result from the use of the asset and its eventual disposition. An asset is deemed to be impaired if its carrying amount exceeds the sum of the expected future cash flows (undiscounted and without interest charges) from the asset. The impairment is measured as the amount by which the carrying amount exceeds the fair value of the asset. After an impairment is recognized, the reduced carrying amount of the asset should be accounted for as the new cost of the asset and depreciated over the remaining useful life. Restoration of previously recognized impairment losses is prohibited.

Lack of an asset-impairment evaluation system may indicate a material weakness in an entity's internal controls. Further, a lack of documentation generally will increase the extent to which judgment must be applied by auditors in evaluating the adequacy of management's write-downs, and will increase the likelihood that differences will result.

Real Estate to Be Disposed Of

All real estate to be disposed of that is not subject to the provisions of APB Opinion 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (FASB, *Current Text*, vol. 1, sec. I13), of which management, having the authority to approve the action, has committed to a plan of disposal, should be reported at the lower of carrying amount or fair value less costs to sell. Subsequent revisions to fair value less costs to sell should be reported as adjustments to the carrying amount of the asset to be disposed of. However, the carrying amount may not be adjusted to an amount greater than the carrying amount of the asset before an adjustment was made to reflect the decision to dispose of the asset. Determination of whether the carrying amounts of real estate projects require write-downs should be done on a project-by-project basis, in accordance with paragraph 24 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects* (FASB, *Current Text*, vol. 2, sec. Re2).

In assessing the valuation of assets to be disposed of, auditors should consider various issues, including the following:

- Has management committed to the plan of disposal? Was the commitment made by management with the authority to approve the action?
- Has fair value been determined using reasonable assumptions and estimates?
- Has the client included appropriate costs in the estimate of costs to sell? Have the costs to sell been discounted, if appropriate?

Cost Capitalization

The real estate industry is now entering the beginning of what could be a substantial construction period. The costs incurred in developing real estate projects range broadly from direct, "brick and mortar" costs to indirect, general and administrative costs. Judgment can be required when determining whether certain costs should be capitalized or expensed, and auditors whose clients are involved in real estate development should consider whether development costs have been capitalized and allocated to individual projects in accordance with GAAP.

The primary guidance on accounting for real estate development costs is provided in FASB Statement No. 67, which establishes whether costs associated with acquiring, developing, constructing, selling, and renting real estate projects should be capitalized. In general, costs that are clearly associated with the acquisition or development of the property should be capitalized; all other costs should be expensed as incurred. Statement No. 67 also provides guidance on allocating capitalized costs to individual projects.

Additionally, FASB Statement No. 34, *Capitalization of Interest Costs* (FASB, *Current Text*, vol. 1, sec. I67), provides guidance on capitalizing interest costs as part of the cost of an asset. The underlying concept in this Statement is that entities should capitalize all the interest that theoretically could have been avoided if expenditures for the asset had not been made.

EITF Issue No. 97-11, *Accounting for Internal Costs Relating to Real Estate Property Acquisitions*, addresses the issue of whether the internal costs of identifying and acquiring properties should be capitalized as part of the cost of an acquisition of real estate. In March 1998 the Task Force reached a consensus that the accounting for such costs depends on whether the property acquired is to be classified as an operating or nonoperating property.

If the property is to be classified as an operating property at the date of the acquisition, then internal costs of preacquisition activities should be expensed as incurred. On the other hand, if a property is to be classified as nonoperating, then the internal costs of preacquisition activities should be capitalized as long as—

- They are directly identifiable with the property.
- They were incurred subsequent to the time that acquisition of the property was considered probable.

Accounting for Lease Modifications

As the demand for space begins to outstrip supply, property owners may seek to negotiate rental increases and shorter lease terms with their tenants. EITF Issue No. 95-17, *Accounting for Modifications to an Operating Lease That Do Not Change the Lease Classi-*

fication, provides guidance when an operating lease is changed by shortening the lease term and increasing the lease payments over the shortened term, but the modifications do not change the lease classification. Under those conditions, the owner's management must determine whether the increased lease rents represent a true modification of future lease payments or are in substance a termination penalty.

- If the increase represents a modification of future lease payments, then the increase should be accounted for prospectively over the shortened lease term.
- If the increase represents a termination penalty, then it should be charged to income in the period in which the lease is modified.

To determine the nature of the modification, the increased lease payments should be compared to market rents and the shortened lease term compared to the original lease's remaining term. The closer the increased payments are to market rents, the more likely the increase represents a modification of future lease payments. However, the greater the difference between the modified term and the original lease's remaining term, the more likely the increase represents a termination penalty.

Regulatory Considerations

A number of real estate entities and certain real estate transactions are subject to government regulation. Auditors should consider these regulations in light of their potential effect on the financial statements being audited.

Additionally, SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards* , vol. 1, AU sec. 317), requires auditors to design their audits to provide reasonable assurance of detecting material misstatements of the financial statements resulting from illegal acts that have a direct and material effect on the determination of financial statement amounts. An audit performed in accordance with GAAS normally does not include procedures specifically designed to detect illegal acts that would have only an indirect effect on the financial statements. Nonetheless, auditors should be aware of the possibility that such illegal acts may have occurred.

U.S. Department of Housing and Urban Development Regulations

Through the Federal Housing Administration, the U.S. Department of Housing and Urban Development (HUD) regulates the development and operation of all of the housing projects for which it insures mortgages or provides rent subsidies. Entities that receive financial assistance from HUD are required to submit audited financial statements to HUD annually. Those audits are required to be performed in accordance with GAAS; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Consolidated Audit Guide for Audits of HUD Programs*, issued by the HUD Office of the Inspector General.

Before accepting HUD audits, auditors should be aware of the HUD oversight program. Representatives of HUD have the ability to review workpapers of individual engagements. If HUD determines that the audit is not in compliance with the HUD audit program, the individual (rather than the firm) who performed the audit can be banned from performing future HUD audits. Furthermore, HUD might refer the matter to the individual's state board of accountancy.

Interstate Land Sales and Full Disclosure Act

Developers are required to make full disclosure in connection with the sale or lease of certain undeveloped subdivided land. The Interstate Land Sales and Full Disclosure Act makes it unlawful for a developer to sell or lease, by use of the mail or any other means of interstate commerce, any land offered as part of a common promotional plan unless the land is registered with the Office of Interstate Land Sales Registration. The Act requires that a printed property report be furnished to all prospective purchasers or lessees. Similarly, the Federal Trade Commission has the authority to act on unfair or deceptive trade practices with respect to real estate sales, particularly as they relate to the marketing and selling activities of real estate companies.

Regulation Z of the Consumer Credit Protection Act

Since most real estate purchases are made on credit, truth-in-lending laws can have a significant effect on real estate financing transactions. Regulation Z of the Consumer Credit Protection Act prescribes requirements for both creditors and borrowers for full disclosure of credit costs that are applicable to all real estate transactions, regardless of amount, in which individual borrowers are involved in nonbusiness transactions. Failure to comply could be considered an illegal act that has an indirect effect on the financial statements.

Segment Disclosures and Non-GAAP Measures of Performance

Many real estate industry executives have long believed that GAAP measures of net income obscure or, in some cases, actually distort the true performance of real estate entities. Their argument is that GAAP methods of depreciation are not a true reflection of the economic depreciation and appreciation experienced by real estate assets.

In 1991, NAREIT adopted the term funds from operations (FFO) as a measurement that would supplement GAAP measures of net income. In 1995 the term was clarified and generally is measured as GAAP net income, excluding gains or losses from debt restructuring and sales of property, plus real estate depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures.

For the past few years, publicly held real estate entities have been presenting FFO or, in some cases, "operating income before depreciation and amortization and write-downs of real estate" in Selected Financial Data and Management's Discussion and Analysis (MD&A). The Securities and Exchange Commission (SEC) staff believes that such financial statement captions are inappropriate because they suggest that the amount represents cash flow for the period, which rarely is the case. "Cash flow from operations" is the appropriate financial statement caption, which must be included in a balanced presentation with cash flows from investing and financing activities when discussing cash flows in MD&A

and elsewhere. Auditors of public entities should read such information and consider whether the information, or the manner of its presentation, is materially consistent with that appearing in the financial statements.

The SEC also notes that neither GAAP nor SEC authoritative accounting literature provides a definition for FFO. The SEC staff's views with respect to the presentation of a cash flow measure as a proxy for net income and the presentation of funds generated from operations are expressed in Accounting Series Release 142. This release states that if such measurements of economic performance are presented in the MD&A section or elsewhere, they should not be presented in a manner that gives them greater authority or prominence than conventionally computed earnings. In no event should the presentation leave the reader with the impression that FFO is the appropriate measure of operating performance for the REIT or an appropriate measure on which to compute and base dividends. Net income and cash flows from operating, investing, and financing activities remain the appropriate measures.

In June 1997, the FASB issued Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* (FASB, *Current Text*, vol. 1, sec. S30). This Standard became effective for financial statements for periods beginning after December 15, 1997.

Among other things, Statement No. 131 establishes standards for the way that public companies report information about operating segments in annual financial statements. The Statement requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments.

FASB Statement No. 131 also requires that a public business enterprise report a measure of segment profit or loss, certain specific revenue and expense items, and segment assets. It requires reconciliations of total segment revenues, total segment profit or loss, total segment assets, and other amounts disclosed for segments to corresponding amounts in the enterprise's general purpose financial statements.

Under Statement No. 131, some industry advocates have encouraged REITs to report FFO as their measure of segment profit and loss in the notes to the financial statements. In May 1998, the EITF issued Topic No. D-70, *Questions Related to the Implementation of FASB Statement No. 131*. In answering questions related to Statement No. 131, the FASB responded that if non-GAAP measures of performance are evaluated by the chief operating decision maker for purposes of evaluating segment performance, then those measures should be disclosed as required by Statement No. 131. Note, however, that FASB Statement No. 131 also requires the segment information to be reconciled to the entity's financial statements. Although EITF Topic No. D-70 specifically addresses earnings before interest, taxes, depreciation, and amortization (EBITDA), it also applies to any similar situation, in this case, FFO.

Auditors whose clients report FFO as segment information must be sure that the accounting policy and procedures for disclosing FFO are in conformity with Statement No. 131. Auditors should determine that management uses FFO in running the business and that the calculation of FFO is consistent with the way FFO is described in the financial statements. Auditors also should test the reconciliation of FFO to the financial statements.

Accounting for Percentage Rents

Some rental agreements, particularly those in the retail industry, provide for minimum rental payments plus contingent rents based on the lessee's operations, for example a future specified sales target. Often, the specified target would not be achieved until the later months of the fiscal year.

In the past, the accounting literature was silent on how contingent rent based on future specified targets should be accounted for in interim financial reporting periods. In practice, many companies accrued these amounts in interim financial statements when it became probable that specified targets would be achieved, rather than waiting until the period when the targets actually were met.

EITF Issue No. 98-9, *Accounting for Contingent Rent in Interim Financial Periods*, reached a consensus that reverses this long-standing practice. Under Issue No. 98-9, lessors must now defer recognition of contingent rental income in interim periods until the specified target that triggers the contingent rental income is achieved. However, at its September 1998 meeting, the EITF decided to reconsider the consensus reached on Issue No. 98-9. Auditors are encouraged to monitor the debate on this issue and its eventual resolution.

Executive Summary—Audit and Accounting Issues of Continuing Importance

- Revenue recognition continues to be a concern as some clients may view the industry recovery as an opportunity to present improved financial results through changes in operating or accounting policies that affect the timing or propriety of revenue recognition.
- In spite of the continued industry recovery, auditors must remain vigilant for the possible impairment of real estate assets.
- The industry is at the beginning of a new development cycle. Auditors should be sure to consider whether costs are capitalized in accordance with GAAP.
- The current economic conditions may lead to property owners attempting to negotiate rental increases and shorter lease terms with their tenants. EITF Issue No. 95-17 addresses the accounting for such lease modifications.
- A number of real estate entities and certain real estate transactions are subject to government regulation under the Interstate Land Sales and Full Disclosure Act, Regulation Z of the Consumer Credit Protection Act, and audit standards promulgated by HUD.

- FASB Statement No. 131 relating to the disclosure of segment information may result in some entities reporting funds from operations (FFO) in the notes to the financial statements. Auditors should consider these disclosures of FFO carefully to be sure they comply with the requirements of Statement No. 131.
- The widely accepted industry practice of accounting for contingent rentals in interim financial statements has changed as a result of the issuance of EITF Issue No. 98-9.

New Auditing and Accounting Pronouncements

What new auditing and accounting pronouncements have been issued this year?

New authoritative pronouncements that deal specifically with real estate industry matters have been discussed elsewhere in this Alert. Auditors should consult *Audit Risk Alert—1998/99* for a more detailed discussion of all new standards not discussed in this Alert. *Audit Risk Alert—1998/99* also describes recently issued SSAEs, auditing Interpretations, attestation Interpretations, AITF Advisories, FASB Technical Bulletins, and EITF Consensus Positions.

The table below summarizes the AICPA SASs, FASB Statements, and AICPA SOPs issued during the past year.

AICPA Statements on Auditing Standards

SAS No. 86	*Amendment to Statement on Auditing Standards No. 72,* Letters for Underwriters and Certain Other Requesting Parties
SAS No. 87	*Restricting the Use of an Auditor's Report*
SAS No. 21	*Segment Information*—Rescinded

FASB Pronouncements

Statement No. 132	*Employers' Disclosures about Pensions and Other Postretirement Benefits* (an amendment of FASB Statements No. 87, 88, and 106)
Statement No. 133	*Accounting for Derivative Instruments and Hedging Activities*
Statement No. 134	*Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise* (an amendment of FASB Statement No. 65)

SOP 97-2	*Software Revenue Recognition*
SOP 97-3	*Accounting by Insurance and Other Enterprises for Insurance-Related Assessments*
SOP 98-1	*Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*
SOP 98-2	*Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*
SOP 98-3	*Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*
SOP 98-4	*Deferral of the Effective Date of a Provision of SOP 97-2,* Software Revenue Recognition.
SOP 98-5	*Reporting on the Costs of Start-Up Activities*
SOP 98-6	*Reporting on Management's Assessment Pursuant to the Life Insurance Ethical Market Conduct Program of the Insurance Marketplace Standards Association*
SOP 98-7	*Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*
SOP 98-8	*Engagements to Perform Year 2000 Agreed-Upon Procedures Attestation Engagements Pursuant to Rule 17a–5 of the Securities Exchange Act of 1934, Rule 17Ad-18 of the Securities Exchange Act of 1934, and Advisories No. 17–98 and No. 40-98 of the Commodity Futures Trading Commission*

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Real Estate Industry CPE Courses

- Self study—Real Estate Accounting and Auditing (product no. 730596)

- Group study—Real Estate Accounting and Auditing

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World Wide Web Site

"AICPA Online," the Institute's Web site (www.aicpa.org), offers CPAs the unique opportunity to stay abreast of developments in accounting and auditing, including exposure drafts. The home page is updated daily. The Web site includes "In Our Opinion," the newsletter of the AICPA Audit and Attest Standards Team. The newsletter provides valuable and timely information on technical activities and developments in auditing and attestation standard setting.

CD-ROM Disk

Practitioners Publishing Company (PPC) and the AICPA are currently offering a CD-ROM disk entitled *The Practitioner's Library—Accounting and Auditing*. This disk includes publications issued by PPC, the AICPA, and the FASB. The disk contains the following publications issued by the FASB: *Original Pronouncements, Current Text, Emerging Issues Task Force Abstracts*, and *FASB Implementation Guides*; and the following publications issued by the AICPA: *Professional Standards, Technical Practice Aids*, and *Audit and Accounting Guides*. The disk also contains eighteen PPC engagement manuals. The disk may be customized so that purchasers pay for and receive only selected segments of the material. For more information about this product call (800) 323-8724.

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This Audit Risk Alert replaces *Real Estate Industry Developments—1997/98*.

Auditors should also be aware of the economic, regulatory, and professional developments that may affect the audits they perform, as described in *Audit Risk Alert—1998/99* and *Compilation and Review Alert—1998/99* which may be obtained by calling the AICPA Order Department.

The Audit Risk Alert *Real Estate Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Alert, please feel free to share them with us. Any other comments that you have about the Alert would also be greatly appreciated. You may email these comments to gdietz@aicpa.org or write to:

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APPENDIX

The Internet: An Auditor's Research Tool

How can auditors use the Internet to plan and conduct the audit of a real estate entity? What kind of information is available on the World Wide Web? Where can this information be found?

The Internet contains a vast amount of information that may be valuable to auditors of real estate entities, including—

- Market forecasts and analyses.
- Discussions of current industry trends.
- Benchmarking studies and comparative financial and nonfinancial data.
- Articles and press releases relating to current industry items of interest.
- Links to other real estate Internet sites.

Audit Risk Alert—1998/99 contains a list of general auditing and accounting sites. Auditors with clients in the real estate industry also may want to consider the following:

Organization	*Internet Address*
Building Owners and Managers Association	www.boma.org
Commercial Investment Real Estate Network	www.ccim.com
Institute of Real Estate Management	www.irem.org
National Association of Real Estate Investment Trusts	www.nareit.org
American Resort Development Association	www.arda.org
National Council of Real Estate Investment Fiduciaries	www.ncreif.org
Real Estate Investment Advisory Council	www.reiac.org

INFORMATION SOURCES

Organization	*General Information*	*Fax Services*	*Web Site Address/Electronic Bulletin Board*	*Recorded Announcements*
American Institute of Certified Public Accountants	*Order Department* Harborside Financial Center, 201 Plaza Three Jersey City, NJ 07311-3881 (888) 777-7077	*24 Hour* *Fax Hotline* (201) 938-3787	Web site: http://www.aicpa.org	
Financial Accounting Standards Board	*Order Department* P.O. Box 5116 Norwalk, CT 06856-5116 (203) 847-0700, ext. 10	*24 Hour* *Fax-on-Demand* (203) 847-0700, menu item 14	Web site: http://www.fasb.org	*Action Alert* *Telephone Line* (203) 847-0700 (ext. 444)
U.S. General Accounting Office	*Superintendent of Documents* U.S. Government Printing Office Washington, DC 20401-0001 (202) 512-1800 (202) 512-2250 (f)		Web site: http://www.goa.gov *The Federal Bulletin Board* includes *Federal Register* notices and the Code of Federal Regulations. Users are usually expected to open	

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